

THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D. C. 20505

National Intelligence Officers

12 March 1979

MEMORANDUM FOR: Director of Central Intelligence
VIA: Deputy Director, National Foreign Assessment
FROM: [REDACTED] National Intelligence Officer for China
SUBJECT: PRC Meeting on Economic Relations with China, Roosevelt Room, 13 March at 1500 hours

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1. Action Requested: Review attached materials dealing with issues discussed during Secretary Blumenthal's trip to China and with further planned developments in US-China economic relations. The PRC meeting, to be chaired by David Aaron, will hear Secretary Blumenthal's report on his trip and consider his recommendations.
2. Background: Secretary Blumenthal visited China from 24 February to March 4 for the purpose of establishing the basis for a new, broadened US-China economic relationship and to clear away if possible the major obstacle to this relationship; namely, the unblocking by the US of frozen Chinese assets for use by the Chinese to pay American claims against them for property seized after the Beijing government took over control of the China mainland in 1949. Secretary Blumenthal attained this last objective, which in turn removed a major obstacle standing in the way of China gaining Most Favored Nation (MFN) tariff treatment for exports sent to the US. With MFN, China's exports would be much more competitive here, and Sino-American trade that much more likely to expand. (The Jackson-Vanik amendment on immigration and other considerations still must be dealt with prior to China's getting MFN, however.)

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3. Also dealt with during the Blumenthal trip were the establishment of a US-China Joint Economic Committee to oversee the development of economic relations; the questions of concluding a trade agreement, MFN, and our granting China Ex-Im Bank financing; the levels which US-China trade might reach (which was estimated by the Chinese at \$20 billion by 1985); China's entry into certain International Financial Institutions; and China's ability to pay for large-scale imports of technology, goods and services. (The Secretary will give his views on why China recently suspended contracts for purchases from Japan.) Finally, Secretary Blumenthal took the opportunity to express to Deng Xiaoping and other senior Chinese leaders our concern over the Chinese attack on Vietnam. Altogether, his visit was quite successful, and laid the groundwork for a follow-up visit on economic matters by Secretary of Commerce Juanita Kreps, who is scheduled to leave for China in early May.

4. During the meeting you may be asked for an assessment of the Soviet reaction to Secretary Blumenthal's trip, which proceeded as scheduled despite the Chinese attack on Vietnam, and was cited by Moscow as evidence of US-China "collusion". An ORPA paper on this subject is at Tab A.

5. Other background materials for your use consist of the following:

a. Memorandum by OER summing up the results of the Blumenthal visit. (Tab B)

b. OER analysis of China's reasons for cancelling contracts with Japan. (Tab C)

c. Account of Secretary Blumenthal's stop in Japan in case this comes up. (Tab D)



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Attachment:
As stated

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Soviet treatment of Secretary Blumenthal's visit to Beijing has been consistent with Moscow's apparent decision to insulate key issues in US-Soviet relations from broad allegations of US connivance with China against Vietnam. The Soviets thus expressed sharp displeasure over the Blumenthal trip, but stopped well short of linking US policy toward the Chinese attack with the outlook for SALT, detente, or US-Soviet relations generally. At the same time, the Secretary's visit has fueled some standing Soviet complaints that the US does not deal even-handedly with Moscow and Beijing. [REDACTED]

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Soviet commentary has repeatedly characterized the Secretary's visit as a "gesture of approval" for Chinese aggression, brushing aside reports that Blumenthal conveyed US opposition to the Chinese action. Reporting on the visit itself, however, was low-key and fairly straightforward; there were no accusations about discussion of possible arms sales, such as the Soviets levelled at a high-level British visit taking place in Beijing at the same time. [REDACTED]

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In a private conversation with a US Embassy Officer on 5 March, however, a Soviet diplomat in Beijing pointed to the Blumenthal visit as evidence that the US was not truly pursuing an evenhanded policy toward the USSR and the PRC. He

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recalled the scheduled visits and exchanges with the Soviet Union that were cancelled at US request over the repression of dissidents during 1978, and--perhaps seeking some assurance-- contended that the decision to go through with the Blumenthal trip signalled US intention to grant most favored nation status to China but not to the USSR.

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SOURCES:

1. Press, unclassified
2. Beijing 1231, 7 March 79, confidential

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9 March 1979

MEMORANDUM FOR: NIO/China

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: Chief, D/C

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SUBJECT

: China - Results of the Blumenthal
Visit

Secretary of Treasury Blumenthal visited the People's Republic of China from February 24 through March 4. In his role as the chief coordinator on US-China economic issues, the Secretary was seeking an agreement on the claims/assets problem and was initiating the first round of substantive talks with the Chinese on bilateral economic and trade issues. Based on the information available, the visit had the following results:

Claims/Assets - At the end of the visit final agreement was reached on a claims/assets settlement and the agreement was initialed by the US and PRC sides. Official detail is not available, but press accounts say that the \$80 million in Chinese assets will be unblocked by the United States. In turn the PRC will make an \$80 million payment to the US which will be used to liquidate the \$197 million in private US claims (at roughly 40 cents on the dollar). The Chinese will pay the \$80 million in 6 installments, the first \$30 million due on October 1, 1979 at which time the Chinese assets will be unblocked. Authorization has been given to Ambassador Woodcock to sign the final agreement.

Joint Economic Committee (JEC) - Agreement was reached on setting up a US-China Joint Economic Committee to coordinate and oversee development of economic relations. For the US side, Secretary Blumenthal will head the JEC with the Secretaries of Labor, Commerce, Energy, Agriculture, Transportation and State, STR, Office of Science and Technology Policy, and Export-Import Bank as members. Vice Premier Yu Qiuli, Chairman of the State Planning Com-

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mission, will lead the Chinese side with members of Cabinet-level rank.

Trade Agreement, MFN, and Ex-Im - Discussions were held on the framework of a trade agreement. The Chinese expressed interest in the early conclusion of an agreement and in receiving most-favored-nation (MFN) status, generalized schedule of preference, and Export-Import Bank financing. The US side laid out the topics to be covered in the proposed agreement including MFN status. Blumenthal expressed hope of completing negotiations on the trade agreement by the end of the year. No information has been given on discussions of the Jackson-Vanik Amendment on free emigration which controls US ability to grant MFN and Ex-Im financing to China under the Trade Act of 1974. Further talks will be held during the Kreps visit in May.

Potential Trade Volume - Both Vice Premier Yu, and Minister of Foreign Trade Li Qiang set the prospective volume of US-China trade at not less than the level of the Sino-Japanese Long Term Trade Agreement, that is, \$20 billion through 1985. Secretary Blumenthal cautioned that the development of trade will encounter obstacles which will require patience and that all areas of the US market will not open as fast as China desires. In particular the problem of Chinese textile exports was raised. The problem of US export controls was also discussed.

Financial Arrangement - Talks were held with both the Minister of Finance and the Bank of China. The Bank of China is planning to open a branch in the US in the near future and may grant reciprocal rights to US banks in the future. China expressed its intention to join the World Bank and the IMF* although it has no plans for a membership bid in the near future. US cooperation was requested on having the World Bank and the IMF expel Taiwan. Details on banking relations and payments procedures will be included in the trade agreement. Export-Import Bank financing, sought by the Chinese, will be handled separately from the trade agreement.

*The so-called International Financial Institutions, or IFI's.

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China's Ability to Pay - During the talks China stated a flexible approach to trade financing to include cash payments, credits, barter, compensation arrangements, and joint ventures. Credits will be used to finance imports of technology and will be repaid through the development of China's extensive natural resources, particularly minerals.

Beijing's recent suspension of contracts for Japanese plant and equipment signed between 16 December and 16 February reflects a temporary shortage of foreign exchange and appears to be aimed primarily at gaining more favorable credit terms from Japan. Negotiations on new plant contracts, however, have slowed drastically since mid-February. One American firm was told not to expect to sign a contract for another 60 days. This may reflect Beijing's need for time to reassess the plan priorities. Nevertheless, the severe cash shortage, resulting from downpayments on the recent flurry of purchases, creates an immediate need to cut back on new contract signings. China's purchases of plant and equipment probably will resume late in the second quarter as foreign exchange earnings become available -- perhaps sooner if China comes to terms on a \$1.5 billion Eurodollar loan. (C)

Appraisal of the Visit - From all reports the Blumenthal visit was quite successful and accomplished the goals, albeit limited, set for the trip. It marks the first substantive step in the normalization of US-China economic relations and sets a framework for further negotiations of the major issues by Secretary of Commerce Kreps during her May visit. Normalization of relations will improve the already favorable climate for US-China trade. Diplomatic relations have lifted China's policy of discrimination against US firms when alternate suppliers were available. Removal of institutional barriers through government-to-government negotiations will further facilitate trade by permitting US firms to compete on an equal footing with Japan and Western Europe. The claims/assets agreement will lift restrictions on direct

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banking, shipping, and airline links. A trade agreement including MFN and the opening of Ex-Im Bank financing for China will provide further incentives to two-way trade. Although substantial growth is likely, the Chinese market is finite limited by its ability to pay and to absorb advanced technology in its economy.

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China Economy Branch
China Division
Office of Economic Research

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Since mid-February, Beijing (Peking) has sent cablegrams to several Japanese trading firms to inform them that a number of plant and machinery contracts are in abeyance because questions of "financing" have not been settled. A Japanese foreign ministry official told the Diet the freeze affects \$2.1 billion of contracts signed since 16 December. The world press has speculated that this move may be related to China's current involvement in Vietnam or to dissension among China's leadership

over the pace and shape of China's modernization program. We, however, believe that the overriding reasons behind the move are, first, a current Chinese shortage of foreign exchange to pay for plants already purchased, and, second, a Chinese effort to pressure Tokyo to provide favorable financing for new purchases. [redacted]

Foreign Exchange Shortage

Between 16 December and 31 December of last year China signed nearly \$5 billion in complete plant contracts—most with Japan—including a steel mill (at Baoshan, near Shanghai) and 29 petrochemical plants. Downpayments on these plants and on \$2 billion in contracts signed over several months prior to 16 December reduced China's foreign currency reserves to \$1.9 billion at yearend 1978. This would be sufficient to cover only about one and a half months' worth of imports—a level Beijing must regard as approaching the minimum that is tolerable. Moreover, in January of this year, China moved a sizable share of these reserves out of short-term time deposits and into call accounts, indicating imminent payments that would have reduced China's currency reserves still further. [redacted]

Pressure for Favorable Terms

For the past two years, Beijing and Tokyo have been haggling over financing for the Chinese projects. The Chinese would like all payments to be made in dollars while the Japanese have insisted on payments in the high-flying yen—at least for the portion of the loans that would be backed by official lending institutions. Liu Xiwen (Liu Hsiwen), China's Vice Minister of Foreign Trade and the top negotiator for the long-term Sino-Japanese Trade Agreement, was scheduled to go to Tokyo in early March to work out the details of a financing package, a settlement that has eluded Chinese and Japanese negotiators ever since the agreement was signed in February 1978. The Chinese probably did not expect as much Japanese intransigence on this issue when contracts were signed, and they are now warning Tokyo that even contracts already linked may be contingent on a Japanese compromise on funding. Recognizing Japanese fears over losing business to the United States, Chinese negotiators have overtly threatened to buy from American firms. [redacted]

During his meetings with Prime Minister Ohira and other Japanese cabinet members on March 4-5, Secretary Blumenthal largely focussed on the need for both short and long range Japanese actions to facilitate final agreement on the multilateral trade negotiations (MTN) package and diminish Japan's persistent trade surplus. In the short run, the Japanese were urged to continue their import stimulation and export restraint programs as well as to move expeditiously toward a solution favoring broader international access to Japanese government procurement and more rapid staging of Japanese tariff reductions under the new MTN agreement. At the same time, however, US officials also stressed that fundamental changes in the pattern of Japanese current account surpluses could only occur as a result of structural shifts in Japan's economy. On China policy, the Secretary noted the need for developed country lenders to avoid excessive export credit competition that could break the OECD export credit guidelines governing the terms and conditions for lending rates to non-market economies.